IN THE SUPREME COURT
APPEAL FROM THE COURT OF APPEALS
JUDGES: MARK J. CAVANAUGH, KATHLEEN JANSEN AND HILDA GAGE

FLUOR ENTERPRISES, INC.

Plaintiff/Appellee/Cross-Appellant,

v

REVENUE DIVISION, DEPARTMENT OF TREASURY, STATE OF MICHIGAN,

Defendant/Appellant/Cross-Appellee.
_____/

Supreme Court Case No. 129149

Court of Appeals Case No. 251005

Court of Claims Case No. 02-27-MT

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# FLUOR ENTERPRISES, INC. APPELLEE BRIEF

## ORAL ARGUMENT REQUESTED

June 28, 2006

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## COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. MCL 208.53(c) ("Section 53(c)") provides that "[r]eceipts derived from services performed for planning, design, or construction activities within this state shall be deemed Michigan receipts." In its April 14, 2005 Opinion in this case, the Court of Appeals held that Section 53(c) attributes to Michigan receipts for "planning," wherever that planning occurs, "design," wherever that design occurs, and "construction activities within this state." The Court of Appeals held that this interpretation of Section 53(c) violated the Commerce Clause of the U.S. Constitution. Is the Court of Appeals' interpretation of Section 53(c) incorrect when it: (1) is not in accord with the plain language of the statute; (2) is not in accord with established rules of statutory construction; and, (3) results in a constitutional infirmity?

   The Court of Appeals answered "No."

   Plaintiff-Appellee answers: "Yes."

   Defendant-Appellant has not addressed this question.

2. Does Section 53(c) prevent Defendant-Appellant from characterizing, as Michigan sales, receipts of Plaintiff-Appellee from planning and design services rendered outside Michigan if Section 53(c) provides that the only receipts that can be attributed to Michigan are those derived from "services performed for planning, design, or construction activities within this state" and the parties have stipulated that the services in question were performed outside of Michigan?

   The Court of Appeals answered: "No," but found the result unconstitutional.

   The Court of Claims answered: "Yes."

   Plaintiff-Appellee answers: "Yes."

   Defendant-Appellant answers: "No."

3. If Section 53(c) is ambiguous, should Plaintiff-Appellee's interpretation of Section 53(c) be accepted because ambiguities in taxing statutes are to be resolved in favor of the taxpayer?

   The Court of Appeals did not decide this issue.

   The Court of Claims did not decide this issue.

   Plaintiff-Appellee answers: "Yes."

   Defendant-Appellant answers: "No."

## I. INTRODUCTION

This case concerns Michigan single business tax ("SBT") imposed upon Plaintiff-Appellee, Fluor Enterprises, Inc. ("Fluor") by Defendant-Appellant, the Michigan Department of Treasury (the "Department"), for fiscal years ending October 31, 1989 through October 31, 1994 (the "Years in Issue").

The receipts at issue in this case relate to receipts received by Fluor for engineering and architectural services performed by Fluor employees outside of Michigan that related to real estate improvement projects constructed in Michigan (the "Subject Receipts"). The Department claims that the Subject Receipts must be considered as rendered in Michigan because that is where the project was constructed. Fluor's position is that such receipts must be considered as rendered in the state in which the engineering and architectural services were actually rendered. The Court of Claims below agreed with Fluor and held that the Subject Receipts, which were for engineering and architectural services, must be sourced to the state in which the engineering and architectural services were performed.

The issue in this case is the proper application of Section 53 of the Michigan Single Business Tax Act ("SBTA"), MCL 208.53, to Fluor's activities. Under the plain language of SBTA Section 53(c), Fluor's receipts from business activity performed outside Michigan cannot be considered as Michigan receipts. Nevertheless, the Department claims that Section 53(c) allows the Department to attribute to Michigan as "Michigan sales" receipts Fluor derived from business activity performed outside Michigan.

The Court of Claims below agreed with Fluor that Section 53(c) does not attribute the Subject Receipts to Michigan because the activities for which the receipts were paid did not occur in Michigan. The Department appealed the Court of Claims decision to the Court of

Appeals and urged to Court of Appeals to accept the Department's position that Section 53(c) attributes the Subject Receipts to Michigan because the construction projects related to those planning and design receipts were located in Michigan. The Court of Appeals, however, adopted neither parties' position and held that Section 53(c) would attribute planning and design receipts to Michigan or any state that enacted an identical statute and was therefore unconstitutional.

In its Appellant's Brief, the Department claims that the Court of Appeals erred in holding that Section 53(c) as interpreted by the Court of Appeals, violated the "internal consistency" requirement and was therefore unconstitutional. The Court of Appeals, however, properly found that Section 53(c), as interpreted by the Court of Appeals, violated the requirement of internal consistency and was unconstitutional. In the context of analyzing Section 53(c), internal consistency requires that Section 53(c), if adopted by every state, would not result in two or more states claiming the same receipts for apportionment purposes. As interpreted by the Court of Appeals, Section 53(c) fails this test because two or more states could claim the receipts for planning and design services.

Adopting the interpretation of Section 53(c) advocated by Fluor (and adopted by the Court of Claims below) removes any such constitutional infirmity. Both Fluor and the Court of Claims believe that Section 53(c) means what it says -- that receipts for certain activities are sourced to Michigan when they occur "within this state." Such an interpretation, if universally adopted, would result in an internally consistent tax system in which only one state (the state in which the activity occurs) would be able to claim the receipts.

The Department also advances an "interpretation" of Section 53(c) that also would source receipts to only one jurisdiction. The Department claims that Section 53(c) should be interpreted to source to Michigan all receipts for planning, design or construction activities when those

activities are related to a construction project that is built in Michigan. The problem with the Department's proposed "interpretation," however, is that it is not supported by the language of Section 53(c) and in order to find for the Department, the Court would literally have to rewrite Section 53(c).

## II. COUNTER-STATEMENT OF FACTS

### A. Facts.

Fluor has submitted, and relies upon, a Statement of Facts in its Cross-Appellant's Brief. Nevertheless, because the Department's Statement of Facts contains some errors, Fluor responds herein to some of the incorrect assertions in the Department's Statement of Facts.

The Department erroneously represents that all the out-of-state engineering and architectural design was performed in California. See Department's Brief on Appeal – Appellant (the "Department's Brief") at 1. This is incorrect and contrary to the Stipulation of Facts. The engineering and architectural services were performed in South Carolina, Illinois, Texas and California. Stipulation of Facts ("SOF"), ¶¶ 7, 9.

Fluor timely filed its SBT annual returns for the Years In Issue. SOF ¶ 10. In its returns for the Years In Issue, Fluor did not attribute to Michigan, as Michigan sales, the Subject Receipts because these receipts were received for activities that occurred outside the state of Michigan. SOF ¶ 11. In its Statement of Facts, the Department asserts that Fluor "failed to properly characterize receipts" and that an audit revealed that Fluor had "neglected to include" receipts. *See* Department's Brief at 1. Fluor's actions however, were neither improper nor the result of neglect because Fluor fully complied with the SBTA.

## III. ARGUMENT

### A. Standard of Review

Fluor agrees with the Standard of Review presented in the Department's Brief. Because this case involves statutory construction and because this case involves review of summary disposition, the Court engages in *de novo* review of the issues presented.

### B. As Interpreted By the Court of Appeals, Section 53(c) Violates The Internal Consistency Requirement.

As interpreted by the Court the Court of Appeals, Section 53(c) is clearly unconstitutional. Section 53(c), which both parties agree controls the disposition of this case, provides the rules for determining whether a taxpayer's receipts for certain activities are sourced to Michigan. That section provides:

> (c) Receipts derived from services performed for planning, design, or construction activities within this state shall be deemed Michigan receipts.

Fluor argued before the Court of Appeals that Section 53(c) allocated to Michigan receipts for certain "activities" (i.e., planning, design or construction activities) when those activities were performed "within this state." Thus, Fluor's position is that the phrase "within this state" modifies the word "activities," which in turn is related to the phrase "planning, design, or construction," which are the activities that must be "performed." Thus, the phrase "within this state" is a necessary condition for receipts for certain performed activities to be allocated to Michigan.

The Court of Appeals, however, held that the term "within this state" modified the only word "activities." *Fluor Enterprises, Inc. v Dep't of Treasury*, 265 Mich App 74, 722; 697 NW2d 539 (2005). The Court of Appeals rebuffed Fluor's interpretation of Section 53(c) by holding that "[Fluor] essentially advocates an interpretation that 'within this state' modifies

'performed,' which is not the last antecedent for the phrase." *Id.* Thus, under the Court of Appeals interpretation, Section 53(c) apparently attributes, as Michigan receipts, receipts performed for "planning" and "design," without regard to where the planning or design occurs, and receipts for "construction activities" if the construction activities occur within Michigan.

The Court of Appeals properly held that Section 53(c) violated the Commerce Clause's requirement of fair apportionment as that statute was interpreted by the Court of Appeals in its Opinion. The Court of Appeals analyzed Section 53(c) under the internal consistency test[1] of fair apportionment required by the United States Supreme Court and held that if Section 53(c) was adopted by more than one jurisdiction, a multi-state taxpayer's business activity would be included in the sales factor of more than one jurisdiction. See 265 Mich App at 728-729. The internal consistency analysis performed by the Court of Appeals was undoubtedly correct because, as interpreted by the Court of Appeals, every state with a statute similar to Section 53(c) would claim, as in-state receipts, receipts derived from services performed for planning and design activities, regardless of the state in which the activities occurred. Thus, each state would claim all receipts for planning and design activities, resulting in duplicative taxation and unconstitutionally putting interstate commerce at a competitive disadvantage. See 265 Mich App at 729-730.

The Department claims that the Court of Appeals analysis of the internal consistency test was in error because the Court of Appeals did not assume that both Michigan and Ohio would apply Section 53(c). See Department's Brief at 13. The Department's argument fails because it is clear that if Ohio and Michigan both relied upon Section 53(c), as interpreted by the Court of

[1] The Department erroneously states that the Court of Appeals raised the issue of internal consistency *sua sponte* because, according to the Department, "[n]either party really briefed or argued the issue." Department's Brief at 8, n. 33. In actuality, Fluor briefed the issue. *See* Fluor's Appellee Brief to the Court of Appeals at 17-22.

Appeals, both states would claim the same receipts. The Court of Appeals interpreted Section 53(c) as attributing, as in-state receipts, receipts for design and planning, regardless of the location where the design or planning occurred. Thus, if Ohio had a similar provision, it would attribute all design and planning receipts to Ohio while Michigan would attribute the same receipts to Michigan. The result would be a violation of the internal consistency test.

It is clear that the requirement of internal consistency mandates that the method of allocating Fluor's receipts for SBT apportionment purposes be such that, if the SBTA was adopted by every other state, none of Fluor's receipts would be "double-counted" and claimed by more than one state. If more than one state claimed Fluor's receipts for apportionment purposes, the result would be that more than 100% of Fluor's tax base would be taxed. This would run afoul of the constitutional requirement that any apportionment formula used in state taxation be such that "if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed." *Container Corp v Franchise Tax Bd*, 463 US 159, 169; 1035 SCt 2933; 77 LEd 2d 545 (1983). Internal consistency requires that a state tax scheme be such that "its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." *Oklahoma Tax Comm'n v Jefferson Lines*, 514 US 175, 185; 115 SCt 1331; 131 LEd 2d 261 (1995). Because an intrastate business never has tax assessed on more than 100% of its tax base, a state tax scheme that, if universally adopted, would result in the imposition of tax upon more than 100% of the tax base of an interstate business would place the interstate business at a disadvantage and be unconstitutional.

Because the constitution requires that Fluor's receipts can only be allocated to one state if Section 53(c) were adopted by every state, Fluor submits that Section 53(c) should be interpreted to allocate receipts received for "planning, design or construction activities" to the state(s) in

which the activities took place. Such an interpretation is in accord with the plain language of Section 53(c) and ensures that only one state could claim the receipts for apportionment purposes.

The Department tacitly admits, as it must, that Section 53(c) must be interpreted to allocate receipts to only one jurisdiction. See Department's Brief at 16-17 (arguing that Section 53(c) is not unconstitutional because it only allocates receipts to one jurisdiction). The Department, however, claims that the jurisdiction to which the receipts should be allocated is the one in which the construction occurs. The problem with this proposed interpretation, as can be seen in the following section, is that it finds no support in the language of the statute.

### C. The Department's Proposed Interpretation Of Section 53(c) Is Unsupportable.

The Department argues that the Court of Appeals "incorrectly characterized the Department's construction of Section 53(c)." Department's Brief at 16. The Court of Appeals did not "incorrectly characterize" the Department's position, it rejected it, and properly so, because the Department's position is unsupported by the language of Section 53(c). The Department points to no language contained in Section 53(c) that supports its position. The Department attempts to re-write and add language to Section 53(c) so that it reads:

> Receipts derived from services performed for planning, design, or construction activities **[for a construction project located]** within this state shall be deemed Michigan receipts. (bolded language added).

Section 53(c), however, does not so read. If the Legislature had wanted Section 53(c) to produce the result advocated by the Department, it could have easily written Section 53(c) to do so. The Legislature did not do so and it is not the province of the Department or the Court to rewrite Section 53(c).

The Department's Brief tacitly admits that its position is unsupported by the language of Section 53(c) because the Department fails to quote, address, or even mention the language of Section 53(c) in the section of its Brief outlining the Department's position.[2] The reason for this omission is obvious – the Department's position is at odds with the language of Section 53(c).

The Department alleges twice in its Brief it has "historically interpreted" Section 53(c) as sourcing receipts for planning and design for construction projects to the state where the construction occurs. See Department's Brief on Appeal at 5, 17. There is absolutely no support in the record for this proposition. The Department attempts to rely on an unauthenticated memorandum dated October 20, 1995 that is dated after the tax years at issue in this case, and almost 20 years after the SBTA was enacted. That unauthenticated memorandum was not put in the record before the Court of Claims and therefore was not part of the record on appeal before the Court of Appeals, see MCR 7.210, and should not be considered by the Court. Furthermore, the memorandum was presumably prepared to support the Department's position in this litigation and was not issued as an administrative interpretation of Section 53(c). Even if the memorandum was evidence of the Department's current interpretation of Section 53(c), it is not evidence of the Department's "historical" interpretation or even its interpretation during the tax years at issue in this case, and it is certainly not a longstanding interpretation, which is the type of interpretation to which courts afford deference. *See In re Michigan Cable Telecommunications Ass'n Complaint*, 239 Mich App 686, 690; 609 NW2d 854 (2000). Finally,

[2] The Revenue Commissioner also never examined or analyzed the language of Section 53(c) when she finalized the tax assessment against Fluor. Instead, she relied totally upon an unauthenticated letter and did not analyze or examine the language of Section 53(c). See Department's Appendix at 26a. This letter, however, is irrelevant to the construction of Section 53(c).

the Department's alleged "interpretation" is at odds with the language of Section 53(c) and must be rejected.

### D. Fluor's Interpretation Does Not Render Section 53(c) Superfluous.

The Department contended below that Fluor's interpretation of Section 53(c) would render that section coextensive with Section 53(a) and therefore superfluous. Because the Department may attempt to make this claim again, Fluor will demonstrate that it is clearly untrue. Section 53 provides:

> Sales, other than sales of tangible personal property, are in this state if:
>
> (a) The business activity is performed in this state.
>
> (b) The business activity is performed both in and outside this state and, based on costs of performance, a greater proportion of the business activity is performed in this state than is performed outside this state.
>
> (c) Receipts derived from services performed for planning, design, or construction activities within this state shall be deemed Michigan receipts.

Section 53(a) clearly applies to business activity that is solely performed in Michigan. Section 53(b) and (c) apply to business activity that occurs both in and outside Michigan. Section 53(c) provides a special rule for construction related activities. Those activities are sourced to the state in which they occur.

A simple example can demonstrate that Fluor's interpretation of Section 53(c) does not render it coextensive with Section 53(a). Consider, for example, the case of a prefabricated building whose major components are designed and built in Tennessee and then shipped into Michigan where the building is assembled and affixed to a foundation. Section 53(a) does not apply because the business activity was performed both inside and outside of Michigan. However, Section 53(c) would source to Michigan those receipts derived from services performed within Michigan (in this case, the receipts for the assembly of the components in

Michigan and affixing the building to its foundation). This simple example shows that Section 53(c) sources to Michigan those receipts that would not otherwise be sourced to Michigan if only Section 53(a) was in effect.

### E. Any Ambiguity Or Doubt In Interpreting Section 53(c) Must Be Resolved In Favor of Fluor.

Taxation statutes must be strictly construed, and all doubt, uncertainty and ambiguity must be resolved in favor of the taxpayer. *Ford Motor Co v State Tax Comm'n*, 400 Mich 499, 506; 255 NW2d 608 (1977). An interpretation advocated by the taxpayer that is consistent with the statute must prevail. *See A. Z. Schmina & Sons, Inc. v Dep't of Treasury*, 203 Mich App 187, 191-92; NW2d 57 (1993). As demonstrated above, not only is Fluor's interpretation consistent with the statute, it is the only position consistent with the statute.

## IV. CONCLUSION

Section 53(c) clearly only requires revenues from planning and design activities performed within Michigan to be included in the sales factor numerator as Michigan receipts. This is so because the statute refers to "services performed for planning, design or construction activities within this state." This is the interpretation by the Court of Claims below. The Department's position requires a tortured construction of Section 53(c). Fluor respectfully requests that the Court reverse the Court of Appeals and accept the interpretation of Section 53(c) adopted by the Court of Claims.

Respectfully submitted,

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Dated: June 28, 2006

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